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## THE REGULATION OF MUNICIPAL UTILITIES

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When Mayor Harrison and I were law students together, Hon. Edward J. Phelps, then one of our professors, and later ambassador at London, told us one thing which I still remember, namely, that it is very difficult to make a thing clear to anyone else if you do not know anything about it yourself. The first step in the consideration of any question is a clear comprehension of just what that question is.

Regulation, in the sense in which the term is used with reference to public utilities, means to subject to rules, restrictions or governing principles.

These rules must be general and fundamental, and should not attempt to cover the details of management. The supreme court of the United States not long ago said (209 U. S. 118):

It must be remembered that railroads are the private property of their owners; that while from the public character of the work in which they are engaged the public has the power to prescribe rules for securing faithful and efficient service and equality between shippers and communities, yet in no proper sense is the public a general manager. . . .

Subject to the two leading prohibitions that their charges shall not be unjust or unreasonable, and that they shall not unjustly discriminate so as to give undue preference or disadvantage to persons or traffic similarly circumstanced, the act to regulate commerce leaves common carriers, as they were at the common law, free to make special rates looking to the increase of their business, to classify their traffic, to adjust and apportion their rates so as to meet the necessities of commerce and of their own situation and relation to it, and generally to manage their important interests upon the same principles which are regarded as sound and adopted in other trades and pursuits.

The public may not undertake the management of these properties because their management is not a public right or a public function; but that the public not only may, but should, establish such fundamental rules or principles as a basis for management and operation as are necessary for its protection, and for the protection

of the utility as well, is not now generally controverted. The experience of the last fifty years has demonstrated that competitive utilities in the same municipal field are not the solution of the question, and that the normal, and generally inevitable, consequence of such a situation is consolidation, frequently preceded by the insolvency of one or more of the utilities in question. As a consequence, the public utility laws adopted within the last few years in a large number of states have established a general public policy which negatives the desirability of such competition.

The questions relating to the regulation of public utilities are important and are growing more so every day. The investment in the United States in the utilities affording service to single communities, such as water, gas, electric light, street railways and local telephone exchanges, excluding railroads, interurban railways and long distance telephone lines, is estimated at nearly nine billions of dollars. By far the greater part of this enormous investment is made up of the savings of hundreds of thousands of frugal people. The service furnished touches, directly or indirectly, not only the pocketbooks but the comfort and convenience of nearly every dweller in every municipality in the country.

The relation between the utility and the public is essentially that of buyer and seller. What the public wants and demands is, first, good service; second, the widest possible extension of this service; and, finally, a fair price. These requirements have been stated in what I believe to be the order of their importance from the public point of view. The thing of greatest moment is that the service be good, in the broad sense that includes efficiency, and everything from courtesy to the character of what is furnished, which is essential to fully meet all reasonable public demands. What comes next is that this service be made available, so far as practicable, to every person in the municipality who desires to utilize it, with only such limitations as must necessarily inhere in the question of cost. Finally, there remains the matter of a fair price.

From the standpoint of the utility, if it is to fulfill these public requirements, there are two things which are absolutely essential. The first is that there be a return from its operation sufficient to constantly attract the new capital which is continually necessary. Anything short of this is less than a reasonable return, and must inevitably result in confiscation. One of the most common and most

misleading errors in the consideration of these questions is to treat a public utility in a growing American city as a completed investment. The investment is never completed. When the plant has been finished and begins operation, the investment has only started. There must be constant additions to it, if the property is to keep pace with the growth of the community, and its obligations to the community are to be performed. These additions demand an unceasing stream of new money, which can only be secured from the general supply of funds seeking investment. This general supply of funds is the aggregate of the public's savings, which the public desires to reinvest. The present remarkable facilities for transportation and for communication are such that neither those seeking investments nor those seeking funds are limited to their own communities, nor, in the case of the larger enterprises, to the United States. This has recently been brought sharply home to us by the desire of foreign holders of American securities to realize upon them, on account of the financial conditions caused by the present European war.

This general market to which the public utilities and all other enterprises desiring to obtain money must go, is in the very nature of things a highly competitive market. Those who have money to invest will invest it where, all things being considered, it will bring to them the highest return. It will go to the highest bidder. Today, and in the near future, public utilities, for the money which they require, must compete not only with all normal demands, but with the enormous abnormal requirements due to the war. Investments in public utilities, just exactly like investments in real estate, manufacturing, banking and everything else, must be attracted by a prospective profit, and this profit, taking into account hazards and other conditions, must be equal to that offered by other available investments. Otherwise, the investors who are seeking a profit will not divert their investments from more profitable enterprises to public utilities. To secure normal, natural business conditions, the profits to be derived by the investor from the various channels of investment must be equal when the variations in hazards and other material conditions are taken into account. When this condition exists, each class of investments will normally secure its proper proportion of the general supply of money. If one class of investments is temporarily more profitable than another, money will flow into that

class until, through the operation of the laws of demand and supply, it is brought into its proper relation with the others. The contention that because money invested in public utilities is devoted to a public use, it is therefore not entitled to relatively the same return as private investments, the conditions, hazards and other factors affecting the investment being considered, will never be sound as long as the laws of demand and supply remain effective. To secure money for investment in public utilities, it is necessary to pay what it is worth in the market, that is, as much as someone else, with a not less attractive investment, will pay for it.

The second essential, from the utility standpoint, is that freedom in the transaction of their business which is necessary to progress, and to efficient, economical operation, and that this freedom be not unduly restricted by attempts at so-called regulation, which are not in fact regulation, but are efforts to control the details of management and operation. The utilities are essential to the public. The public is just as essential to the utilities. The public welfare requires that the interests of each be protected and that the rights of neither party be violated. What tribunal should stand between the buyer and seller and maintain the scales in equilibrium?

Regulation costs money. It is not an over-statement to say that millions of dollars are being spent every year for this purpose in the United States. In the ultimate analysis, this burden inevitably falls upon the public. It is an item in the cost of the service. To justify what it must pay for this regulation, the public must derive benefits more than equal to its cost.

To make regulation of benefit to the community, and to justify the enormous expense which it imposes upon the public, several things are necessary:

1. The regulatory body must be composed of men of unquestioned integrity and force of character.

To make regulation worth anything, the regulatory body must have, and this means it must earn and be entitled to, the respect and confidence of both of the interested parties, so that its conclusions, even though unacceptable, will be promptly accepted both by the public and by the utilities which are affected by them. It must, as far as possible, be free from all influences which would militate against a just, impartial, business-like administration.

2. The men composing the regulatory body must have not only the capacity but also the business and special training necessary to the proper determination of the important and intricate questions which are presented to it.

The successful management and operation of a public utility require ability of the first order, combined with special training and experience. The regulatory body, while not engaged in management or operation, must be able to thoroughly understand all of the questions presented by management and operation.

3. The regulatory body should be composed of men who are free from other interests and engagements which would tend to prevent their giving to the performance of their duties the time which is requisite if sound results are to be obtained.

The value of the results attained will vary in almost direct proportion with the approach to meeting these requirements.

If these general considerations are sound, the conclusion is inevitable that the regulation of municipal utilities should be not local but in the hands of state commissions. The municipality is the representative of the buyer. The identical considerations which prohibit the utility from being an arbiter between itself and the public negative the propriety of local regulation. No man may or should sit as a judge in his own case.

I have no sympathy with the unwarranted attacks which are so frequently made upon the integrity and capacity of city officials and members of city councils. The public selects them, and it does not lie in the mouth of the public to discredit the men whom it has selected. But these men are elected. They are inevitably subject to constant, direct, most persuasive political influences which they cannot ignore, and which they ought not to ignore. They regard themselves as the representatives of the public, and they would be unfaithful to the trust which is reposed in them if they did not.

But these very considerations which should be the subject of commendation and not of criticism, disqualify them to act as judges in matters in which they, as individuals, and the public generally are directly interested. The decisions of such tribunals can never inspire confidence. A decision in favor of the public is immediately criticized as due to political considerations. A decision against the public arouses suspicion as to considerations of a different character, and a compromise is criticized as political.

Moreover, members of city councils cannot, in the very nature of things, acquire the special knowledge and experience necessary to the correct determination of the many varied, intricate and important questions which arise out of the regulation of public utilities. They are, in the very large majority of cases, men whose personal

affairs must have their first consideration, and who can give, and are only expected to give, to the public business a relatively small proportion of their time and effort. They usually do not hold office long enough to acquire the experience necessary in order to make them efficient in the numerous special subjects involved in the regulation of utilities.

There has been criticism, much of it unjust, of the participation of public utilities in municipal politics. The utilities do not belong in politics; where they are in politics, it is not of their own volition, but because conditions beyond their control have forced them in. Their regulation by city authorities must inevitably bring them into intimate relations with every political faction in the community. This always has been, and always will be one of the results of municipal regulation.

State commissions, with the advantages of relative permanency in office, permanent staffs of experts and accountants, and freedom from local political influences, have not been able to attain results with which they themselves have been satisfied. City councils or city boards which are subject to all of the difficulties which state commissions meet, and are subject to many from which state commissions are free, must, in the very nature of things, be less efficient and less successful as regulatory bodies than state commissions.

The local self-government argument is not a sound one. The public interest does not require the local authorities to do things which may be better done by others. If what it is desired to accomplish by regulation is to equitably adjust the differences which naturally arise between the public and public utilities, so that the public may have good service, widely extended, at a fair price, and so that the business of the utilities may be upon the stable basis which is necessary to enable them to render this service, and to make possible the development which is essential to the public interest, then there is absolutely nothing in the local-self-government argument. The real question is, how can this regulation be best accomplished? If it can be best accomplished by the local tribunal, then it should be done by that tribunal, not because it is local, but because it is best. If it can be best accomplished by a state tribunal, then the public should have the state tribunal and should not take something that is not as good, in order to have this work done locally.

There are some things which cannot be accomplished by regu-

lation, and it is well to have this clearly in mind. The idea seems to be more or less prevalent that the function of regulation is to decrease prices and impose burdens upon the public utilities. Every burden upon a public utility is a burden upon the public, which in the final analysis must pay the bills. If the burden brings with it a benefit that is worth to the public what it pays for it, the public can afford it. Otherwise, it cannot.

Rates cannot be indefinitely reduced by regulation. The downward tendency in rates that has been constant in recent years has been partially met by economies brought about through efficiency in management and operation; but there is a limit to what may be accomplished by such economies, and if this limit has not already been reached, it will be soon.

But what it is desired to emphasize is, not that existing rates are low, but that neither by regulation nor by anything else can the public buy this service for less than it is worth; that neither by regulation nor by anything else can the public, speaking broadly, have this service without paying for it what it costs, including as a part of that cost a reasonable profit upon the money invested in furnishing the service. Nobody has ever been able to get something for nothing for long. Ever since trade commenced, the cost of any article, or of any service, has been an important factor in fixing its price. The farmer cannot raise and sell his cattle and hogs and grain for less than they cost; the manufacturer cannot manufacture and sell his product for less than it costs; the merchant cannot buy and sell his merchandise for less than it costs. To attempt to do this is to invite bankruptcy. Public service corporations are not exempt from the operation of general, fundamental, economic laws. The operation of these laws makes it impossible for them to furnish service for less than it costs, this cost including, as has been said, the profit that is necessary to secure the requisite capital. Regulation cannot change these laws. Regulation cannot enable a public utility to buy rails, or cast iron pipe, or copper, or labor at less than it is worth in the market. Regulation cannot enable a public utility to buy money at less than it is worth in the market. And until regulation can do this, it cannot secure the service of these utilities for less than it is worth. Unjust regulation might wreck some public service corporations. Unjust regulation might drive public service corporations out of business, but for it to enable the public to

secure something for nothing, to secure a service for less than it is fairly worth, is an economic impossibility.

There is an important corollary to this proposition. An insolvent public service corporation never gave good service. It never gave good service, because it is not within the power of such a corporation to give good service. A notable illustration of such a situation is afforded by the conditions surrounding the street railroad traffic in Chicago a few years ago, before an adjustment was made between the companies and the city which enabled the companies to secure new money. Only a prosperous public service corporation can furnish good service, because good service requires money. Money is necessary to secure an adequate number of competent employes; it is necessary to maintain the property in the condition which is a prerequisite to first-class service; it is necessary to make the replacements, renewals and additions which are required if the plant is to be adequate and up-to-date, instead of inadequate and obsolete; it is necessary to provide for the additions and the surplus capacity which are absolutely essential if the public is to have the service when it needs it and where it needs it. This service the public can have by paying for it. It cannot have it without paying for it, simply because a public service corporation, just like a farmer or a manufacturer or a merchant, cannot live without a profit.

The matter of the regulation of municipal utilities is still in the development stage in this country. This is true, both as to the law and as to the practice and procedure. If this development is to result in successful regulation—and by successful regulation I mean something that will contribute substantially to the welfare of the public as a whole—this must be accomplished through the coöperation of the public and the public utilities, with a frank recognition of the principles which have been discussed. It should result in good will, decreased cost and increased efficiency.